No. 99-476

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In The

Supreme Court of the United States

VALENCE TECHNOLOGY, INC.,
CARL E. BERG, LEV M. DAWSON,
CALVIN L. REED, DALE R. SHACKLE,

Petitioners,

vs.

JAMES I. BERRY; JAMES VARANO; GREGG M. WEISS; PETER GARUCCIO, M.D.; P.C. PENSION PLAN; FREDERICK JEWETT; MILBURNE E. ESTES; JOSEPH P. YONKE; INVESTAR PARTNERSHIP; EUGENE HONEYMAN; ANNE KANTOR; MURRAY GOLDSMITH; MORTON SURKIN; FLORENCE SURKIN; ROBERT LEIMSIDER; GILBERT BERGELSON, on behalf of themselves and all others similarly situated,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

REPLY IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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SUMMARY

Three matters raised in the Opposition Brief confirm the existence of matters suitable for, indeed demanding, this Court's review.

First. Respondents ignore the conflict between the Second Circuit's inquiry notice standard, which is prospective and can be practically applied by lawyers and potential litigants, and the retrospective standards of the Seventh and Tenth Circuits, which can only be discerned by litigants when applied by a reviewing court. Opposition ("Opp.") 6. This case presents a straightforward opportunity for this Court to choose a rule.

Second. Respondents admit at one point that the Ninth Circuit held that the *Forbes* article could not constitute the "discovery of the facts constituting the violation" because the article "made no allegation of actual fraud." (Opp. 8 & n.3). But Respondents' attempt to reconcile this holding to *United States v. Kubrick*, 444 U.S. 111 (1979), is both unsupported and unbelievable. *Kubrick* holds that it is reversible error to link the onset of a limitations period to the plaintiff's knowledge of the legal consequences of the facts of injury and causation. *Id.* at 122. The Ninth Circuit plainly committed this mistake, and thereby departed from this Court's jurisprudence, exemplified by *Kubrick*.

Third. Apart from their treatment of *Kubrick*, Respondents repeatedly misstate the Ninth Circuit's holding in this case in an effort to make the holding appear less radical than it is. The trial court examined *Forbes* and held as a matter of law that the article would put *any* reasonable person on notice. The Ninth Circuit looked at the same article and held that *no* reasonable person could read it and suspect fraud. Appendix ("App.") 12. Respondents, however, inaccurately suggest that the Ninth Circuit merely held that Petitioners failed to carry their burden of proof to show that *Forbes* necessarily triggered

the limitations period for the "fraud" later alleged. Opp. 7. The obviously consequential difference is that between failing to establish an affirmative defense as a matter of law (in which case a jury question would remain), and what happened here – where the defense was summarily decided in the Court of Appeals in favor of Respondents, although they made no motion for summary judgment.

In taking the issue of notice from a jury, and in departing from principles exemplified by *Kubrick*, the Ninth Circuit necessarily adopted a standard of notice that is more onerous for defendants than any other prevailing in the Courts of Appeals. This case squarely puts the proper legal standard of notice at issue.

THE CIRCUIT CONFLICT

Respondents contend the petition rests on trivial word play among the Courts of Appeals. Not so. At issue is an outcome-determinative debate about the meaning of the words this Court used to define the statute of limitations for claims arising under Securities Exchange Act Section 10(b): "the discovery of the facts constituting the violation." *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 364 & n.9 (1991).

The circuits are in conflict about what "discovery" encompasses: is the purpose of the one-year limitations period to permit a potential litigant to investigate and promptly file a claim, or is a plaintiff given a year after all of the claim's pieces are in place to see if litigation is attractive?

The Second and Fourth Circuits take the former view. *Dodds v. Cigna Securities, Inc.*, 12 F.3d 346, 351 (2d Cir. 1993), *cert. denied*, 511 U.S. 1019 (1994); *Cooke v. Manufactured Homes, Inc.*, 998 F.2d 1256, 1263 (4th Cir. 1993). This was surely the rule in the Ninth Circuit prior to *Lampf*. *Davis v. Birr, Wilson & Co.*, 839 F.2d 1369, 1370 (9th Cir. 1988); *Volk v. D.A. Davidson & Co.*, 816 F.2d 1406 (9th Cir.

1987). It was the rule applied by the District Court. App. 30-32.

The Seventh Circuit has its own test, which looks at the confluence of suspicious circumstances and the ease of access to information that can confirm the suspicions by a reasonably diligent investigation. *Fujisawa Pharm. Co., Ltd. v. Kapoor*, 115 F.3d 1332, 1334 (7th Cir. 1997). The Seventh Circuit recognized the possibility of commencing the one-year period at the point apparently fixed by the Ninth Circuit here, when "the victim has in hand all the facts he needs to bring suit immediately," but rejected that view as "untenable." *Id.* The investor should not be permitted to "complete his investigation, draft his complaint, and put the complaint in a drawer to be taken out in a year and filed if the price of the stock has fallen." *Id.*

The Ninth Circuit has now taken a contrary, indeed unique, view. Apparently taking *Lampf* as an opportunity to evade its own inquiry notice precedent (App. 8), the Ninth Circuit says that the one-year limitations period *starts* only *after* the plaintiff's investigation should have collected the facts "underlying the alleged fraud." App. 11. How the facts "underlying the alleged fraud" may differ from "the facts constituting the violation" is unclear, but the Ninth Circuit's vague test appears to offer a plaintiff poised to sue at least a year (depending on when a court finally decides "discovery" occurred) to see if a risky investment in a volatile technology stock will pay off or fail. The Seventh Circuit calls this rule "Heads I win, tails you lose." *Tregenza v. Great American Comm. Co.*, 12 F.3d 717, 722 (7th Cir. 1993), *cert. denied*, 511 U.S. 1085 (1994).

That the differences between these tests are not "semantic" can be easily illustrated here (assuming that the *Forbes* disclosures are legally sufficient to excite inquiry, as the District Court concluded). Under the Second Circuit's test, the year commences on the publication

of *Forbes*, and this lawsuit was untimely. Under the formulation of the Seventh Circuit's test in *Fujisawa*, the year begins when suspicion is aroused, provided that the facts necessary to file a complaint could have been assembled within a year of aroused suspicion. Under the test endorsed by the Ninth Circuit, however, the year apparently does not even start until the time it would end in the Seventh Circuit. App. 11.[1]

The Ninth Circuit does not stop by formulating its own distinctive test of notice. Based on a three-sentence analysis, the court says that when this Court picked Exchange Act Section 9(e)'s limitations provision for Section 10(b) claims it "explicitly chose a provision requiring actual discovery over other provisions allowing inquiry notice. . . . " App. 9. The Ninth Circuit left wholly unaddressed Justice Kennedy's dissenting observation that the Court "does not identify any reasons for finding one [of the two formulations of the relevant, borrowed statute of limitations] to be controlling." *Lampf*, 501 U.S. at 375. Per the Ninth Circuit, however: "*Lampf* does appear unequivocal on this point. . . . " App. 8. No other circuit thinks so.

The Ninth Circuit's attempt to resolve this case while professing not to decide the governing notice standard fails. The Court necessarily applies a notice standard that is less favorable to defendants, as we now show.

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[1] There appear to be other conflicts as well. In the Ninth Circuit, inquiry notice imposes on plaintiffs the burden of creating a triable factual issue with evidence that they failed to discover the fraud despite the exercise of reasonable diligence. *See, e.g., Briskin v. Ernst & Ernst*, 589 F.2d 1363, 1366 n.3 (9th Cir. 1978). Respondents here did not. In the Seventh Circuit, it may be defendants' burden to show that diligence would lead to discovery. *Law v. Medco Research, Inc.*, 113 F.3d 781, 786 (7th Cir. 1997).

THE NINTH CIRCUIT'S ERRORS

Lampf ties the onset of the statutory period to the discovery of "the facts constituting the violation." Focus on what must be "discovered" illuminates the timeliness of the issue presented for this Court's review and resolution. In order to understand the proper presentation of that issue, we take a closer look at the Ninth Circuit's errors.

Respondents repeatedly suggest that the Ninth Circuit merely held that petitioners had failed to carry a burden of proof establishing an affirmative defense as a matter of law. Opp. 1, 3, 7. Not so. The Ninth Circuit held that the *Forbes* article did not help arouse suspicion of fraud as a matter of law. App. 15. Generically applied to this record, this viewpoint means that facts suggesting that big contracts and products are not what the company claims, presented alongside charges that "insiders" elsewhere "accused of securities fraud" are "unloading" shares in a company with a "levitated" stock price *would not* lead any reasonable reader to suspect anything that might eventually suggest a claim for securities fraud. App. 13-15. The Ninth Circuit had to come to this remarkable and unsupportable conclusion to avoid squarely facing the notice question.

In reaching this conclusion, the Ninth Circuit did something *other* than evaluate whether *Forbes* disclosed "the facts constituting the violation" alleged. The Ninth Circuit erroneously decided the notice effect of *Forbes* by considering one possible conclusion of an investigation of its charges. Respondents suggest that the Ninth Circuit did not err in looking to extraneous facts to determine whether *Forbes* constituted notice of the alleged fraud, arguing that defendants invited the court to engage in just such an exercise. Opp. 9. But Respondents fail, as did the Ninth Circuit, to distinguish in practice the two phases of the limitations analysis identified by the court. First, does the matter alleged to constitute notice arouse a suspicion of

fraud that would cause a reasonable person to investigate that possibility? Second, would a reasonable investigation uncover facts sufficient to permit the filing of a complaint? App. 11-12.

The Ninth Circuit erroneously collapsed these questions. The court reasoned that the article would not induce a reasonable investor to investigate the possibility of fraud, because reliance on a few of the facts that might be collected during such an investigation could support a conclusion other than fraud. App. 13-15. In other words, *Forbes* would not provoke a shareholder to investigate, because the investigation might lead to an innocuous conclusion. App. 15. This species of circular reasoning is not only inarguably a fallacy, it is easily and completely distinguishable from the analysis that was urged on the courts below by Petitioners: whether factual confirmation of a suspicion aroused is readily available. Instead of analyzing whether a reasonably diligent investigation could have turned up facts confirming suspicions aroused by *Forbes* (as the District Court did), the Ninth Circuit erroneously concluded that if an investigation might possibly support an innocent explanation, then notice does not exist.

This error ties closely to another, decisive mistake, the existence of which Respondents admit in the course of trying to deny it: the Ninth Circuit held that *Forbes* could not provide notice of possible fraud because it "made no allegation of actual fraud." App. 12; Opp. 8. Claiming that the "factual record strongly supports the Ninth Circuit's conclusion," Respondents can only repeat the conclusion. Opp. 8.

Respondents then attempt to distinguish or dismiss *United States v. Kubrick*, in which this Court corrected precisely the error made by the Ninth Circuit here. Respondents first suggest that the Ninth Circuit did not run afoul of *Kubrick* because Respondents were not aware of their injury and its likely cause until Valence announced in May, 1994 that it could not build batteries to Motorola's

then-existing specifications. Opp. 8, n.3. If this is a factual assertion, it has no support in the record. If it is an argument, the facts indicate its absurdity: credulous shareholders (who did not, and indeed could not, suspect fraud prior to Valence's May 3 announcement) first suspected fraud out of a clear blue sky, and that day hired lawyers, who drafted and filed class action fraud complaints mere hours later. App. 6-7.

Respondents' argument further ignores the nature of their claims. This class action securities claim rests on the "fraud on the market" theory. That theory holds that investors are injured when they buy shares of stock at prices artificially inflated by actionable misstatements or omissions. *Basic, Inc. v. Levinson*, 485 U.S. 224, 245 (1988). The injury does not occur when the artificial inflation is allegedly purged from the stock price by the market's reaction to some later revelation. *Eckstein v. Balcor Film Investors*, 8 F.3d 1121, 1127-28 (7th Cir. 1993) ("[d]iscovering that one has lost money is not the same as discovering that one has been defrauded"). As petitioners noted, and as Respondents ignore, it was exactly this alleged injury (artificial inflation in the stock price) and its likely cause (allegedly misleading statements made by persons standing to profit from sales of the stock) that *Forbes* identified: *Forbes* indicated that "the Motorola purchase order, which boosted the stock 4$^{3}/_{8}$ points when it was announced in December" was "much less than meets the eye," because it was not a firm commitment, but merely a contingent purchase order. App. 25. That December announcement of the contract contained the statement "the significance of the Motorola agreement can't be overestimated;" when Respondents finally sued, they claimed that this very statement had fraudulently inflated Valence's stock price for precisely the reason "disclosed" by *Forbes*. App. 35.

The District Court correctly followed the trail leading from the *Forbes* article to this lawsuit, concluding that "the facts disclosed and charges leveled by *Forbes* bear nearly a

one-to-one correspondence to the allegations of Plaintiffs' original complaint." App. 35. *Forbes* thus disclosed in February, 1993 the "facts" constituting the "violation" alleged in May, 1994. For the Ninth Circuit, however, this was not enough, because the article "made no allegation of actual fraud." App. 12. This is the error that caused this Court to reverse the Third Circuit in *Kubrick*, and the Court should grant certiorari to do the same here.

Before *Lampf*, the Ninth Circuit held the view that the "purpose of the Securities Exchange Act is to protect the innocent investor, not one who loses his innocence and then waits to see how his investment turns out before he decides to invoke the provisions of the Act." *Volk*, 816 F.2d at 1413. The rule was that "investors must bring their lawsuits when they should discover that they paid an inflated price for securities as a result of misleading statements or omissions." *Id.* at 1414. "[A]ctual or inquiry notice that a fraudulent misrepresentation has been made" was sufficient. *Id.* at 1412. That view was consistent with this Court's precedent. The Exchange Act "was designed to protect investors against manipulation of stock prices." *Basic, Inc.*, 485 U.S. at 230. It should not permit prospective litigants to "await developments on the sidelines without risk." *Blue Chip Stamps v. Manor Drug Store*, 421 U.S. 723, 747 (1975).

The Ninth Circuit opinion below takes *Lampf* to displace this precedent with a rule that gives investors – if they are ever on notice – a year to play the market. No good purpose is served by a rule that invites the "opportunistic use of federal securities law to protect investors against market risk." *Tregenza*, 12 F.3d at 722. Review is thus necessary to determine whether, as Respondents suggest, traditional notions of inquiry notice in the Ninth Circuit in fact survive this Court's decision in *Lampf*, or whether, as the court below held, *Lampf* means that the statute of limitations on a Section 10(b) claim cannot begin

to run unless a prospective plaintiff is first hit over the head with an "allegation of actual fraud."

THIS CASE NECESSARILY PRESENTS FOR REVIEW THE ISSUE OF THE PROPER TEST OF NOTICE

No matter what it claims to have done, the Ninth Circuit necessarily adopted and applied a standard of notice, because it held that *Forbes* could not constitute notice. That standard is more onerous than the aroused suspicion and inquiry standards of the Second and Fourth Circuits, and more onerous than the Seventh Circuit's test, which includes a look at the opportunity available to acquire additional information through investigation once suspicion is aroused. The Ninth Circuit's inquiry notice standard, contrary to every other circuit, requires allegations of actual fraud and facts that, once investigated, would only tend to confirm the conclusion that fraud exists.

As shown above, the Ninth Circuit did not merely hold that Petitioners had failed to carry their burden of proof to establish an affirmative defense, as Respondents inaccurately claim. If that had been the case, there would have remained an issue of fact for a jury, and the Ninth Circuit would have had to remand to the trial court with instructions. It did not. App. 15, n.9. What the Ninth Circuit did instead was to take it upon itself to grant judgment as a matter of law in favor of Respondents, who neither made nor supported such a motion in the trial court. Thus, the Ninth Circuit necessarily created and applied a rule of law on notice that conflicts with the rule in other circuits.

In this connection, Respondents argue that Petitioners want to re-argue facts to this Court. Petitioners, however, seek only this Court's review of the legal significance of a manageable and narrowly defined set of facts: what was disclosed in the *Forbes* article, what was later alleged by Respondents to constitute fraud, the time elapsing between the two events, and the record presented on this

issue at summary judgment. This is nothing like the invitation the Court declined in *Klehr v. A.O. Smith Corp.*, 521 U.S. 179, 193 (1997) (Civil RICO).

CONCLUSION

Offering a time-honored reason for denying certiorari, Respondents argue that this Court should permit *Lampf* to "percolate" so that the circuits can "fine-tune" purportedly inconsequential variations in their inquiry notice standards. Opp. 6-7. This Court has not dismissed the differences in the circuits' discovery rules so lightly, and has indeed indicated that it might review a case where the issues mattered and were presented sharply. *Klehr*, 521 U.S. at 191-193. There is no reason why this Court should permit the Ninth Circuit's decision to cast a shadow of doubt over the application of the discovery rule or to obfuscate material differences among the circuits on the application of the discovery and inquiry notice principles.

Petitioners sought and were denied rehearing and *en banc* review. They are now left with no alternative but to ask this Court to correct the Ninth Circuit's errors. The petition for certiorari to the Court of Appeals for the Ninth Circuit should be granted.

DATED: November 10, 1999

Respectfully submitted,

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